

Number: **201327003**
Release Date: 7/5/2013
Index Number: 355.01-01

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:CORP:B02
PLR-146015-12

Date:
April 08, 2013

Legend

Distributing =

Controlled =

State A =

State B =

Business AA =

Trust W =

Trust X =

Trust Y =

Trust Z =

LLC =

Region 1 =

Year 1 =

$$\underline{a} =$$
b =

Dear _____ :

This letter responds to your representative's October 19, 2012 letter requesting rulings as to the federal income tax consequences of the proposed transactions. The material information submitted in that letter and subsequent correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding: (i) whether the distribution described below satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) whether the distribution is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see Section 355(a)(1)(B) of the Internal Revenue Code ("Code") and Treas. Reg. § 1.355-2(d)); and (iii) whether this distribution is part of a plan (or a series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing 50 percent or greater interest in the distributing corporation ("Distributing") or the controlled corporation ("Controlled") (see Section 355(e) and Treas. Reg. §1.355-7).

FACTS

Distributing is a State A calendar year S corporation. Distributing has been in existence since Year 1 and is primarily engaged in Business AA. Distributing has two classes of common stock, Class A and Class B. There are a Class A shares outstanding and b Class B shares outstanding. The only difference between the two classes of stock is that only Class A shares are entitled to notice of or to vote any action required or permitted by law to be approved by the shareholders. Trust W and Trust X each own half the Class A shares, and Trust Y and Trust Z each own half the Class B shares. Hereinafter, Trust X and Trust Z will be referred to as "Shareholder 1", and Trust W and Trust Y will be referred to as "Shareholder 2." Prior to the proposed transaction, Shareholder 1 and Shareholder 2 each own half of the interest in Distributing.

The shareholders desire to separate the operation of Business AA into two entities to resolve problems that arise from operating the business in various geographic locations and an increasingly divergent shareholder base.

Prior to the separation, Distributing will contribute four pieces of real property to a wholly owned limited liability company ("LLC"). Distributing will distribute all its interest in the

LLC to Shareholder 1 and Shareholder 2 pro rata in a taxable distribution. Distributing will lease certain pieces of property from LLC at market value.

PROPOSED TRANSACTION

For what are represented as valid business reasons and in order to achieve the objectives discussed above, Distributing proposes the following transaction ("Proposed Transaction"):

1. Distributing will cause the formation of wholly owned corporation ("Controlled") in State A. Controlled will have a Class A shares and b Class B shares outstanding. The only difference between the two classes of stock is that only Class A shares are entitled to notice of or to vote any action required or permitted by law to be approved by the shareholders.
2. Distributing will contribute 50 percent of its assets to Controlled in exchange for all of Controlled's outstanding stock ("Contribution"). The contributed assets will constitute Distributing's Business AA in Region 1 (including trademarks and a piece of real estate in State B).
3. Distributing will distribute all of Controlled's Class A and Class B stock to Shareholder 2 in exchange for all of Shareholder 2's Class A and Class B stock in Distributing ("Distribution"). Following the Distribution, Controlled will elect to be taxed as a Subchapter S corporation.

Distributing and Controlled will enter into a trademark assignment and license back agreement that will allow Distributing and Controlled the right to use trademarks in their respective regions.

REPRESENTATIONS

Distributing has made the following representations in connection with the Proposed Transaction:

- (a) The fair market value of the Controlled stock to be received by Shareholder 2 will be approximately equal to the fair market value of the Distributing stock surrendered.
- (b) No part of the consideration to be distributed by Distributing will be received by Shareholder 2 as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) Distributing, Controlled and Shareholder 2 will each pay their own expenses, if any, incurred in connection with the Distribution.

- (d) The five years of financial information submitted on behalf of Distributing is representative of its present operations, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) No intercorporate debt will exist between Distributing and Controlled at the time of, or after, the Distribution.
- (f) Following the Distribution, Distributing and Controlled will each continue the active conduct of its respective business independently and with its separate employees.
- (g) Distributing will retain approximately 28 employees who perform accounting, human resources, purchasing, and data processing functions. Controlled will have access to the services of these employees for up to 24 months after the Distribution. Controlled will be billed by Distributing for the use of these employees based on actual use and the allocable share of expenses related to these employees.
- (h) The Distribution is being carried out for the following business purposes: to enhance the success of the business by enabling the corporations to resolve management, systemic, or other problems that arise (or are exacerbated) by the taxpayer's operation of business in various geographic locations within a single corporation and an increasingly divergent shareholder base. The Distribution is motivated, in whole or substantial part, by one of these corporate business purposes.
- (i) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. §1.355-7) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50 percent or greater interest (within the meaning of Section 355(d)(4)) in either Distributing or Controlled, including any predecessor or successor of any such corporation.
- (j) Immediately after the transaction (as defined in Section 355(g)(4)), either (i) no person will hold a 50 percent or greater interest (within the meaning of Section 355(g)(3)) in Distributing or Controlled, (ii) if any person holds a 50 percent or greater interest (within the meaning of Section 355(g)(3)) in any disqualified investment corporation (within the meaning of Section 355(g)(2)), such person will have held such interest in such corporation immediately before the transaction, or (iii) neither Distributing or Controlled will be a disqualified investment corporation (within the meaning of Section 355(g)(2)).

- (k) For purposes of Section 355(d), immediately after the Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in Sections 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution.
- (l) For purposes of Section 355(d), immediately after the Distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was (i) acquired by purchase (as defined in Sections 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in Sections 355(d)(5) and (8)) during the five year period (determined after applying Section 355(d)(6)) ending on the date of Distribution.
- (m) The liabilities to be assumed (as determined under Section 357(d)) in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (n) No two parties to the transaction are investment companies as defined in Sections 368(a)(2)(F)(iii) and (iv).
- (o) The Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (p) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (q) The total fair market value of the assets transferred from Distributing to Controlled will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of Section 357(d)) by Controlled, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under Section 361(a) without the recognition of gain) received by Distributing in the Contribution. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.

- (r) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of any liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (s) Distributing is an S corporation within the meaning of Section 1361(a). Controlled will elect to be an S corporation pursuant to Section 1362(a) on the first available date after the Distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

RULINGS

Based solely on the information submitted and the representations set forth above, we rule as follows:

- (1) The Contribution, followed by the Distribution will qualify as a reorganization within the meaning of Section 368(a)(1)(D). Distributing and Controlled will each be a party to the reorganization within the meaning of Section 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution (Sections 361(a) and 357(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (Section 1032(a)).
- (4) The basis of each asset received by Controlled will equal the basis of that asset in the hands of Distributing immediately before the Contribution (Section 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period during which Distributing held that asset (Section 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (Section 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) Shareholder 2 on the Distribution (Section 355(a)(1)).
- (8) The basis of the Controlled stock in the hands of Shareholder 2 immediately after the Distribution will equal Shareholder 2's basis in the Distributing stock surrendered (Section 358(a)(1)).
- (9) The holding period of the Controlled stock received by Shareholder 2 will include the holding period of the Distributing stock surrendered by the shareholder in

exchange therefor, provided such stock is held as a capital asset on the date of the Distribution (Section 1223(1)).

- (10) Proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Section 312(h) and Treas. Reg. § 1.312-10(a).
- (11) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which the earnings and profits will be allocated under Section 312(h) (see Treas. Reg. §§ 1.312-10(a) and 1.1368-2(d)(3)).
- (12) Provided that the Distribution is undertaken immediately after the Contribution, Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under Section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under Section 1361(b)(1)(B) and will not, in itself, render Controlled ineligible to elect to be an S corporation for its first taxable year.

CAVEATS

Except as specifically provided herein, we express no opinion concerning the tax consequences of any aspect of any matter or item discussed or referenced in this letter. Moreover, no opinion is expressed about the tax treatment of the transactions or of any other matter under other provisions of the Code or regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see Section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d));
- (iii) Whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in the Distributing or the Controlled (see Section 355(e) and Treas. Reg. § 1.355-7);
- (iv) Whether Distributing or Controlled otherwise meet the requirements of a subchapter S corporation under Section 1361; or

- (v) The tax consequences of the trademark assignment and license back agreement between Distributing and Controlled.

PROCEDURAL STATEMENTS

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this letter may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of this ruling letter.

Pursuant to the power of attorney on file in this matter, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Gerald B. Fleming
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel (Corporate)